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Nos. 14-840 & 14-841

IN THE
Supreme Court of the United States

FEDERAL ENERGY REGULATORY COMMISSION,
Petitioner,

v.

ELECTRIC POWER SUPPLY ASSOCIATION, *et al*,
Respondents.

ENERNOC, INC. *et al*,
Petitioners,

v.

ELECTRIC POWER SUPPLY ASSOCIATION, *et al*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the D.C. Circuit

BRIEF OF RESPONDENT CALIFORNIA INDEPENDENT SYSTEM OPERATOR IN SUPPORT OF PETITIONERS

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QUESTION PRESENTED

The States and the federal government share regulatory authority over the Nation's electric power system. States regulate retail sales of electricity. *See* 16 U.S.C. § 824(b)(1). The Federal Energy Regulatory Commission, for its part, has jurisdiction over "the sale of electric energy at wholesale in interstate commerce," and "the transmission of electric energy in interstate commerce." *Id.* In regulating sales and transmission in interstate commerce, FERC must, among other things, change "any rule, regulation, practice, or contract affecting such rate, charge, or classification" that is "unjust, unreasonable, unduly discriminatory, or preferential." 16 U.S.C. § 824e(a).

The question presented is whether the Federal Power Act, 16 U.S.C. § 791a, *et seq.*, gives FERC jurisdiction to regulate "demand response" programs whereby operators of wholesale electricity markets pay users to reduce their energy consumption and recoup those costs through adjustments in wholesale rates.

RULE 29.6 DISCLOSURE STATEMENT

CAISO is a nonprofit public benefit corporation organized under the laws of the State of California. It is responsible for the reliable operation of the bulk of the electricity grid in the State of California and a smaller portion of Nevada, comprising the transmission systems of several entities: San Diego Gas & Electric Company, Southern California Edison Company, Pacific Gas and Electric Company, the Cities of Vernon, Pasadena, Anaheim, Azusa, Banning, and Riverside, California, Startrans IO, L.L.C., Atlantic Path 15, LLC, the Western Area Power Administration, Sierra Nevada Region (with regard to the Path 15 transmission lines in California), Trans Bay Cable LLC, and Valley Electric Association, Inc.

CAISO issues no shares, but from time to time has issued debt securities to the public. CAISO has no affiliates, parent companies, or subsidiaries.

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INTRODUCTION

Utilities have historically responded to rising demand for electricity by increasing the amount of generated power available. Demand response pro-

grams changed that dynamic; they pay users to commit to reduce their consumption of electricity at peak usage times. Recognizing that demand reductions represent an alternative to constructing expensive new generation facilities needed only at times of peak usage, Congress has declared it to be "'the policy of the United States that time-based pricing and other forms of demand response * * * shall be encouraged * * * and unnecessary barriers to demand response participation in energy, capacity and ancillary service markets shall be eliminated.'" *See* FERC Pet. App. 3a (citing *Ind. Util. Reg. Comm'n* v. *FERC*, 668 F.3d 735, 736 (D.C. Cir 2012) (citing 16 U.S.C. § 2642)). The California Independent System Operator (CAISO), which operates transmission in California and Nevada, and administers wholesale electricity markets across various western states, has been at the forefront of efforts to fulfill that objective.

The D.C. Circuit's limited view of FERC's jurisdiction threatens to upend these emerging strategies for balancing the supply of and demand for electricity. The CAISO opposed certain aspects of FERC's policy on compensation for demand response providers as a petitioner in the D.C. Circuit. But it nevertheless shares FERC's (and other petitioners') concern that serious negative consequences will flow from the D.C. Circuit's crabbed view of FERC's jurisdiction. *See* FERC Pet. 19-29; EnerNOC Pet. 20-28. The CAISO files this additional brief to underscore the harm the D.C. Circuit's decision could work on the national power grid. Certiorari should be granted.

STATEMENT

1. As part of its effort to promote competition in a free market for wholesale electricity, FERC has encouraged the creation of independent entities that oversee state or regional networks of transmission lines. Such organizations, referred to as Regional Transmission Organizations (RTOs) and Independent System Operators (ISOs), manage the flow of electricity across the high-voltage long-distance power lines that make up power grids and ensure that utilities have equal access to transmission lines. Utilities still own transmission infrastructure, but the ISO or RTO acts essentially as a traffic controller for the grid to maximize the efficiency of the transmission system and its generation resources. ISOs and RTOs also perform a critical market function, facilitating tens of thousands of transactions every day to help ensure enough power is on hand to meet demand.

ISOs and RTOs benefit the overall power grid by enhancing reliability, establishing fair prices that reflect supply and demand, improving system transparency, and expanding access to green power sources. In particular, ISOs help balance the supply and demand for electricity—in industry parlance, "generation" and "load"—on an ongoing basis. One tool for achieving that balance is "demand response," a set of strategies that improve the reliability, performance, and efficiency of the electric grid by reducing or delaying electricity usage during peak periods. *See* 18 C.F.R. § 35.28(b)(4) (defining demand response). Demand-response programs encourage users to limit their electricity consumption when the grid would otherwise have to turn to more costly

generating stations in order to meet the current demand, or else curtail the demand involuntarily. *See* FERC Pet. App. 3a (citing *Ind. Util. Reg. Comm'n* v. *FERC*, 668 F.3d 735, 736 (D.C. Cir 2012) (citing 16 U.S.C. § 2642)). These systems typically automate the process of reducing electricity usage (e.g., by deploying software to adjust thermostats or hot water heaters) at times of peak electricity usage, such as the hottest parts of summer days. Demand response programs may be implemented by large commercial or industrial electricity users, traditional load-serving electric utilities, or by aggregators—a new kind of business that supplies the automation services and pools the reductions of many smaller customers. *See, e.g.*, EnerNOC Pet. 10-11.

2. The CAISO operates the electric transmission system throughout much of California and administers wholesale markets for energy and transmission-related services. The 26,000 circuit miles of power lines under the CAISO's responsibility constitute most of the transmission facilities in California and extend into Nevada, serving more than thirty million customers. And in late 2014, the CAISO expanded its market to include a real-time energy balancing function that is available to entities in other states, including Oregon, Utah, and Wyoming. *See Cal. Indep. Sys. Operator Corp.*, 147 FERC ¶ 61231 (2014) (authorizing CAISO to expand into other states to operate its real-time imbalance energy market, which matches generation with load and maintains the frequency of the electric grid).

The CAISO can use its market to balance supply and demand efficiently—including by reducing demand. Utilities serving retail customers schedule

forecasted demand in the "day-ahead" market, and demand-response providers, which can operate independently of utilities, submit bids to curtail some of that consumption. The CAISO then determines how the overall system can most efficiently meet the forecasted demand—either by increasing supply by adding a generator or by decreasing demand by accepting demand-response providers' bids.

As a nonprofit public benefit corporation, the CAISO has no financial interest in any particular demand-response provider or any other participant in its markets. Its interest lies with ensuring reliable transmission service and the efficient operation of wholesale markets—both of which depend on consistent, transparent, and predictable regulation.

3. In 2010, and pursuant to FERC orders, the CAISO began to allow "proxy demand resources" to participate in its markets. Proxy demand resources are electricity consumers or aggregations of consumers capable of reducing their demand in response to dispatch instructions from the CAISO, and may participate in CAISO markets through a demand-response provider. Subject to the outcome of this case, the CAISO makes payments to proxy demand resources based on their performance in reducing demand. *See Cal. Indep. Sys. Operator Corp.*, 132 FERC ¶ 61045, 61300 (2010).

FERC issued Order No. 745 in 2011, establishing a standard for compensating demand-response providers participating in day-ahead and real-time energy markets (like those the CAISO operates) that set the rates for wholesale electricity in a given region. *See* FERC Pet. App. 3a. Under Order No. 745, demand-response providers receive the same price that

CAISO would pay to generators for energy, based on the amount of reduction they deliver. *See* FERC Pet. App. 3a. FERC conditioned the payment of full market price "on the ability of a demand response resource to replace a generation resource[,] and required demand response to be cost effective." FERC Pet. App. 3a. Cost-effectiveness would be "determined by the net benefits test," which "recognizes that, depending on the change in [market price] relative to the size of the energy market, dispatching demand-response resources may result in an increased cost per unit ($/MWh) to the remaining wholesale load associated with the decreased amount of load paying the bill." FERC Pet. App. 55a; *see* FERC Pet. 11.

FERC's Order prompted a number of questions about the meaning of its directive and its impact on the CAISO's proxy demand response program. But the Commission subsequently denied the CAISO's and various other stakeholders' requests for clarification and rehearing of Order No. 745. FERC Pet. App. 176a, 179a-180a. The CAISO sought review of the Order in the D.C. Circuit. Other petitioners challenged FERC's authority to regulate demand response under the Federal Power Act, contending that FERC had impermissibly intruded into retail rate-setting, an area subject to the jurisdiction of the States, not FERC. *See* 16 U.S.C. § 824d, 824e.

4. A divided D.C. Circuit panel vacated Order No. 745 in its entirety. FERC Pet. App. 2a. The panel majority agreed that demand-response compensation directly affects the wholesale market, observing that "a change in one market will inevitably beget a change in the other. Reducing retail consumption—

through demand-response payments—will lower the wholesale price. Demand response will also increase system reliability." FERC Pet. App. 7a. But the panel declined to endorse the Commission's contention that "[b]ecause incentive-driven demand response affects the wholesale market in these ways, * * * §§ 205 and 206 [of the Federal Power Act] are clear grants of agency power to promulgate *Order No. 745*." *Id.* As the majority saw things, FERC's power under sections 205 and 206 is subject to the requirement that it not regulate a matter under state control, *id.* at 10a, and "[d]emand response—simply put—is part of the retail market. It involves retail customers, their decision whether to purchase at retail, and the levels of retail electricity consumption." *Id.* at 11a (emphases omitted). Accordingly, the majority found that FERC's effort to regulate demand response in Order No. 745 was beyond its statutory authority. *Id.* at 14a.

Judge Edwards dissented, observing that the issue "turn[ed] on a rather straightforward question of statutory interpretation: whether a promise to *forgo* consumption of electricity that would have been purchased in a retail electricity market unambiguously constitutes a 'sale of electric energy' " exclusively within the jurisdiction of the states. FERC Pet. App. 20a. Because he found the statute to be ambiguous on this point, Judge Edwards would have deferred to the Commission's reasonable interpretation of the Federal Power Act. *Id.* at 21a.

As an alternative holding, the panel addressed FERC's rules on compensation set forth in Order No. 745. The majority found that FERC had not adequately explained how its system results in "just

compensation." *Id.* at 15a.[1] Judge Edwards also dissented from that conclusion. *Id.* at 21a.

The D.C. Circuit denied petitions for rehearing from FERC and from nominally prevailing parties, including the CAISO. FERC Pet. App. 284a-285a.

REASONS FOR GRANTING THE WRIT

FERC and the CAISO disagree about the substantive merits of Order No. 745. But they are aligned on the key issue before this Court: the D.C. Circuit misapplied core statutory interpretation principles in concluding that FERC lacks jurisdiction over demand-response participation in wholesale markets.

Congress not only empowered FERC to regulate wholesale rates; it expressly charged the agency with ensuring that "*any* rule, regulation, practice, or contract *affecting* such rate, charge, or classification" is just and reasonable. 16 U.S.C. § 824e(a) (emphases added). That is why this Court repeatedly has confirmed that FERC has jurisdiction over practices directly affecting jurisdictional rates. *See Miss. Power & Light Co.* v. *Miss. ex rel. Moore*, 487 U.S. 354, 371 (1988); *see also Schneidewind* v. *ANR Pipeline Co.*, 485 U.S. 293, 308 (1988) (interpreting the Natural Gas Act).

By exempting all demand response from FERC's regulation, the D.C. Circuit's decision imposes a twofold harm: FERC is stripped of its congressionally-mandated authority to regulate practices—like demand response—that directly affect wholesale

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[1] The CAISO does not seek to challenge this alternative holding.

rates, while the CAISO and other multi-jurisdictional ISOs and RTOs are left subject to the potentially conflicting regulatory and policy agendas of the many states they serve. This regime cannot be what Congress envisioned when it charged the federal government with "encourag[ing]" and removing "unnecessary barriers" to demand response. *See* 16 U.S.C. § 2642.

Although the CAISO disagrees with FERC on the ultimate fate of Order No. 745, it endorses the jurisdictional arguments made in the Commission's petition and responds here to highlight the real-world problems caused by the D.C. Circuit's mistaken understanding of the Federal Power Act.

I. THE D.C. CIRCUIT'S DECISION WILL IMPEDE THE DEVELOPMENT OF DEMAND-RESPONSE STRATEGIES.

As FERC and EnerNOC have explained, the D.C. Circuit's conclusion that FERC lacks jurisdiction to regulate wholesale demand response is incorrect. *See supra at* 2. But just as pernicious for the affected markets, the ultimate scope of the D.C. Circuit's jurisdictional holding is also *unclear*: The panel majority's decision could be read in different ways that yield different consequences for the industry and the electric grid. This Court's intervention is needed to ensure that regulatory uncertainty does not deter demand-response providers from playing the important role in our Nation's energy future that Congress intended.

1. The D.C. Circuit's opinion *could* be narrowly interpreted in such a way that, while significantly limiting FERC's freedom to act in this area, leaves

the agency at least a little authority to regulate. Order No. 745 authorized ISOs to make payments to, among others, independent demand-response providers. Independent demand-response providers gather promised demand reductions from a variety of consumers and bid those decreases into an ISO's markets; they do not supply power to those users—a role typically filled by local utilities. The D.C. Circuit appeared to assume that the compensation these demand-response providers receive would be passed along, potentially in full, to retail electricity consumers. *See* FERC Pet. App. 11a.

If payment to *consumers* is the jurisdiction-removing fact, ISOs may have other options. For example, they could limit participation in their markets to state-regulated load-serving entities (those that actually provide the power to retail customers, including traditional utilities) and compensate only the load-serving entity, whose relationships with its retail customers in turn are state-regulated. States could then assume complete control over how (and if) those payments are passed through to consumers, eliminating the problem of "an ISO [compensating] a consumer for reducing its demand." FERC Pet. App. 11a.[2]

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[2] In a recent tariff amendment, PJM indicated that it plans to take a version of this route. It will allow only load-serving utilities to participate in its demand-response programs, and it will make no payments at all for demand reductions. Instead, PJM will offer utilities an offset against their obligation to procure capacity in PJM's long-term capacity market. *PJM Interconnection L.L.C.*, Docket No. ER15-852-000 (Jan. 14, 2015) (proposing tariff amendment).

Another option under a narrow reading of the D.C. Circuit's decision might be to structure demand-response transactions as two sales. Throughout this case and in Order No. 745 itself, FERC maintained that the demand-response programs subject to the Order *did not* involve wholesale sales. *See* FERC Pet. App. 6a. That characterization made sense for the business models considered in Order No. 745. But FERC could also approve rules that structure demand response as a purchase of electricity in the day-ahead market to serve the retail customer and a "sale back" in the real-time market, after the demand response is dispatched, to reflect the amount of electricity the customers did not use. Such transactions, which would be undertaken with the wholesale utility, would take ISOs fully out of the business of compensating retail customers, and thus would fall more squarely outside states' "exclusive authority to regulate the retail market." FERC Pet. App. 8a (citing *Niagara Mohawk Power Corp.* v. *FERC*, 452 F.3d 822, 824 (D.C. Cir. 2006)).

2. At the other end of the spectrum, it is also possible to contemplate an expansive interpretation of the D.C. Circuit's opinion. The court of appeals emphasized that demand response has a single definition: "a reduction in the consumption of electric energy by customers from their expected consumption in response to an increase in the price of electric energy or to incentive payments designed to induce lower consumption of electric energy." FERC Pet. App. 5a-6a (citing 18 C.F.R. § 35.28(b)(4)) (emphasis omitted). The D.C. Circuit went on to explain that "[d]emand response—simply put—is part of the *retail* market. It involves *retail* customers, their decision whether to

purchase *at retail*, and the levels of *retail* electricity consumption." FERC Pet. App. 11a. That description—which considers only one of many facets of a demand program integrated into the wholesale marketplace—could be understood as a categorical bar on FERC's regulation of any ISO participation *at all* in an effort to balance the grid by reducing demand.

* * *

Both of these interpretations—the narrow and the broad—flow from a fundamentally incorrect reading of the Federal Power Act. But the very ambiguity in the D.C. Circuit's flawed holding compounds the problem. Demand response emerged as an important part of our national energy strategy only in the last two decades. New demand-response business models are still in formation, and companies must necessarily grow quickly to aggregate enough customers reducing their demand to gain traction in the marketplace. But with the will-they-or-won't-they regulatory uncertainty the D.C. Circuit has introduced into the market, investors reasonably will be loath to commit resources to a business subject to such uncertainty. A failure to grow new demand-response businesses would significantly impede the CAISO's ability to advance the policies of California and other western states concerning energy resources and climate change, which is central to its business plans. *See, e.g.*, California Independent System Operator, *Demand Response Barriers Study*, at ¶ 7.4.1 (describing infrastructure and systems costs as a barrier to entry into the demand-response business) (Apr. 28, 2009), *available at* http://www.caiso.com/Documents/DemandResponseB

arriersStudy.pdf. Potential providers may remain on the sidelines, halting the progress of efforts to reduce energy consumption, during the years it takes to sort out what the D.C. Circuit meant. The CAISO's plans depend on the future availability and growth of demand-response resources, and will require a dramatic overhaul if their availability is uncertain. This Court should act now to prevent the economic damage that will ensue while the industry waits.

II. THE D.C. CIRCUIT'S OPINION WILL SUBJECT ISOs AND RTOs TO AN UNWORKABLE PATCHWORK OF DEMAND RESPONSE REGULATIONS.

Although the majority found that FERC's regulation of demand response interfered with state regulation of retail rates, the decision left it unclear where—if anywhere—the authority to regulate demand response lies.

1. Even under a narrow reading, the D.C. Circuit's opinion could restrict demand-response programs in ways that reduce their effectiveness. ISOs and RTOs could still open their markets to demand-response providers, but their participation would be structured not as *supply* resources (i.e., an alternative to bringing additional power generating capability online) but as *load*-modifying resources. That difference matters. In their current form, demand-response providers can compete directly with generation resources. When optimizing the balance of the energy grid for a particular day or hour, the ISO market software compares demand-response bids with power-supply resources (i.e., generators) to determine whether it is most cost effective to achieve

balance by increasing supply or by reducing demand. That competition creates a variety of benefits: lower costs to consumers, incentives to generate power in the most efficient way possible, and the allocation of demand-response resources when and where they are most needed.

Under a narrow reading, the court of appeals' decision would likely change a key feature of this arrangement. To avoid the effect on state-regulated transactions with retail customers that the panel opinion appears to foreclose, all demand-response resources would have to be treated in the marketplace as adjustments to load instead of supply resources. The ISO could still specify requirements for demand response, such as triggers for the time and location where load modification is desired. But demand-response providers would not directly compete with generation providers in the markets for energy rents or capacity payments. As a result, the market would become less efficient for a variety of reasons, among them the fact that the ISO or RTO has greater control over supply-side resources but demand cannot be further shaped in real time. Greater control may lead the marketplace to favor *supply*-side providers in cases where, if the playing field were level, activating *demand* would be more efficient.

This change would curtail the ability of demand-response providers to offer a clean and inexpensive alternative to additional generation. The result: increased reliance on the least resource-efficient generators in the network.

2. The broader interpretation of the D.C. Circuit opinion is even more problematic. If FERC were

unable to regulate demand response *at all*, the Commission could not approve tariff provisions governing demand response, and ISOs and RTOs could be required to remove the provisions currently in place.

The electricity system as a whole might still be able to make use of demand response through state-regulated programs. But if jurisdiction belongs solely to state authorities, ISOs and RTOs—the only entities with visibility over the entire electric system—will be unable to maximize the value of demand response by dispatching it when and where it is most needed for efficient operations, because demand response will not be part of optimizing the real-time market in response to actual grid conditions. This limit alone would severely undermine the value of demand response to the electric system.

And before demand response could have any value to the electric system under the broader interpretation of the D.C. Circuit opinion, ISOs and RTOs would have to overcome a number of obstacles. For example, no ISO or RTO tariff provisions could specify the characteristics of various load-modifying demand-response products, such as when, where, and how quickly the demand response must be available; how much load can be reduced for how long; and how many times can the resource be called up. All of these matters presumably would be subject to *state* regulation without companion wholesale market rules, since FERC would not have the power to approve such rules. As a result, the system operator would lack authority to ensure that the demand response it dispatches will actually meet its requirements for maintaining the reliability of the

system, making the resources much less useful.

What's more, without enforceable rules embodied in a tariff, ISOs and RTOs cannot impose a penalty or create a financial incentive to ensure that the promised reduction in electricity usage actually occurs. That would compound the risk of relying on a demand-response resource for load-balancing purposes; if an entity under state jurisdiction failed to deliver its load-modifying demand response, the ISO or RTO could violate federal reliability standards, incurring financial penalties.

The situation becomes even more complicated when multiple states join the fray. Maintaining open access to a reliable transmission is increasingly an interstate enterprise. The CAISO recently began operating its real-time electricity markets to serve customers in multiple states. *See supra* at 4. Other RTOs also operate electricity markets across state lines; for example, PJM Interconnection provides service in 13 states. If multiple state authorities were to issue conflicting demand-response regulations, it would be difficult, if not impossible, for multi-state ISOs and RTOs to accommodate those diverse regulations in their markets. They may find it necessary to ignore demand response efforts when balancing the grid (forcing the expansion of power generation facilities to be used during periods of high demand).

III. THE D.C. CIRCUIT'S DECISION WILL HAVE FAR-REACHING EFFECTS ON THE NATION'S ENERGY SUPPLY.

Congress recognized that meeting our Nation's growing energy needs will require new sources of

supply *and* innovative tools for controlling and shaping demand. *See supra* at 2. Demand response forms a critical component of that strategy. In addition to its significant role in price formation, demand response helps maintain grid reliability. *See* FERC Pet. 31-33. And reductions in energy demand contribute to national efforts to reduce reliance on the carbon-based fuels that speed climate change. *See* EnerNOC Pet. 28-30.

The D.C. Circuit's decision will have widespread and disruptive impacts on the nation's wholesale electricity markets. The majority's conclusion that FERC lacks jurisdiction over demand response exposes demand-response initiatives to conflicting directives from multiple jurisdictional authorities. It also creates uncertainty concerning the status of an array of demand response-related provisions contained within the FERC-approved tariffs of the CAISO and other transmission operators that were not directly at issue in the specific FERC order under review. These impacts could derail the efforts of the CAISO and other wholesale electricity market operators to implement the nation's energy policy by efficiently expanding demand response. The effect of the panel majority's ruling will ultimately be felt in increased prices for electricity.

CONCLUSION

For the foregoing reasons, and for those described in the United States' and EnerNOC's petitions, the petitions for a writ of certiorari should be granted on the jurisdictional question presented therein.

Respectfully Submitted,

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